

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 MARC SPITZER, Chairman  
4 JIM IRVIN  
5 WILLIAM A. MUNDELL  
6 JEFF HATCH-MILLER  
7 MIKE GLEASON

8 In the matter of )

9 **UBS WARBURG LLC**  
10 **677 Washington Boulevard**  
11 **Stamford, Connecticut 06901**  
12 **CRD# 7654**

) DOCKET NO. S-03498A-03-0000

)  
)  
)  
) DECISION NO. 65912

13 **UBS PAINWEBBER INC.**  
14 **1285 Avenue of the Americas**  
15 **New York, New York 10019**  
16 **CRD #8174**

)  
) **ORDER TO CEASE AND DESIST, ORDER**  
) **FOR ADMINISTRATIVE PENALTIES AND**  
) **CONSENT TO SAME**  
) **BY: UBS WARBURG LLC AND**  
) **UBS PAINWEBBER INC.**

17 Respondents.  
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WHEREAS, UBS PaineWebber Inc. ("UBS PaineWebber") is a broker-dealer registered in the state of Arizona since January 1957; and

WHEREAS, UBS Warburg LLC ("UBS Warburg") is a broker-dealer registered in the state of Arizona since November 1992 ; and

WHEREAS, for purposes of this Order, PaineWebber, UBS PaineWebber, and UBS Warburg and will be collectively referred to as UBS or the Firm, except in circumstances where PaineWebber, UBS PaineWebber or UBS Warburg are specifically referenced.

WHEREAS, coordinated investigations into the Firm's activities in connection with certain of its equity research practices during the period of approximately 1999 through 2001 have been conducted by a multi-state task force and a joint task force of the U.S. Securities and Exchange Commission ("SEC"), the New York Stock Exchange ("Exchange"), and the National Association of Securities Dealers ("NASD") (collectively, the "regulators"); and

WHEREAS, the Firm has advised regulators of its agreement to resolve the issues raised in the

1 investigations relating to its research practices; and

2 WHEREAS, the Firm agrees to implement certain changes with respect to its research practices  
3 to achieve compliance with all regulations and any undertakings set forth or incorporated herein  
4 governing research analysts, and to make certain payments; and

5 NOW, THEREFORE, the Arizona Corporation Commission (“Commission”) hereby enters  
6 this Order:

7 **I.**

8 The Firm elects to permanently waive any right to a hearing and appeal under Articles 11 and  
9 12 of the Securities Act of Arizona, A.R.S. §44-1801 *et seq.* (“Securities Act”) and Title 14 of the  
10 Arizona Administrative Code with respect to this Order To Cease and Desist and Order for  
11 Administrative Penalties (“Order”); neither admits nor denies the Findings of Fact and Conclusions  
12 of Law contained in this Order, and consents to the entry of this Order by the Arizona Corporation  
13 Commission (“Commission”).

14 **FINDINGS OF FACT**

15 **A. Background and Jurisdiction**

- 16 1) UBS Warburg became a member organization of the Exchange on September 6, 1985. It is  
17 principally owned by UBS AG (UBS AG was formed through the June 1998 merger of  
18 Union Bank of Switzerland with Swiss Bank Corporation) and is engaged in the business of  
19 global investment banking and securities. UBS Warburg also provides services on a  
20 worldwide basis, including investment banking, securities trading and principal  
21 investments, and asset management. The principal office of UBS Warburg is located at 677  
22 Washington Boulevard, in Stamford, Connecticut.
- 23 2) PaineWebber Inc. (“PaineWebber”), founded in 1879, was a full-service securities firm  
24 located in New York, and became a member of the Exchange on November 17, 1982. The  
25 services provided by PaineWebber, on a global basis, included investment banking,  
26 research, trading, investing on a principal basis, and asset management.

- 1 3) On November 3, 2000, UBS AG purchased PaineWebber and PaineWebber became known  
2 as UBS PaineWebber. UBS PaineWebber is indirectly owned by UBS AG. As part of the  
3 merger, PaineWebber banking and research activities were shifted to UBS Warburg LLC,  
4 and some investment bankers and research analysts previously employed by PaineWebber  
5 became employees of UBS Warburg LLC. Since the merger, UBS PaineWebber is  
6 principally engaged in the business of servicing retail investors and no longer employs  
7 equity investment bankers or research analysts. UBS PaineWebber's principal office is  
8 located at 1285 Avenue of the Americas, New York, New York.
- 9 4) UBS AG has offices in over 50 countries, employing approximately 69,500 people, 35,000  
10 of whom work for UBS PaineWebber or UBS Warburg. UBS Warburg has 90 stock  
11 exchange memberships in 30 countries and the firm's 500 equity research analysts cover  
12 about 3,300 companies world-wide.
- 13 5) UBS Warburg and UBS PaineWebber are registered with the Exchange, SEC, NASD and  
14 with all 50 states, the District of Columbia and Puerto Rico.

## 15 **B. Overview**

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- 17 1) This action concerns the research and investment banking activities at UBS Warburg during  
18 the period July 1, 1999 through June 30, 2001 as well as the research and investment  
19 banking activities at PaineWebber from July 1, 1999 until its merger with UBS AG on  
20 November 3, 2000 (the "relevant periods").
- 21 2) During the relevant period, as set forth below, the Firm sought and did investment banking  
22 business with many companies covered by the Firm's Research Department. Research  
23 analysts were encouraged to participate in investment banking activities and that was a  
24 factor considered in the analysts' compensation. In addition, the decision to initiate and  
25 maintain research coverage of certain companies was in some cases coordinated with the  
26 Investment Banking Department and influenced by investment banking interests.

1 3) As a result of the foregoing, as set forth below, certain research analysts at the Firm were  
2 subject to investment banking influences and conflicts of interest between supporting the  
3 investment banking business at the Firm and publishing objective research.

4 4) As set forth below, the Firm had knowledge of these investment banking influences and  
5 conflicts of interest, yet failed to establish and maintain adequate policies, systems and  
6 procedures with respect to research analysts that were reasonably designed to detect and  
7 prevent those influences or manage those conflicts.

### 8 **C. The Role of the Research Analyst**

9 1) Research analysts were responsible for providing analyses of the financial outlook of  
10 particular companies in the context of the business sectors in which those companies  
11 operate and the securities markets as a whole.

12 2) The Firm publishes research on publicly traded companies based upon analysts' examining,  
13 among other things, financial information contained in public filings, questioning company  
14 management, investigating customer and supplier relationships, evaluating companies'  
15 business plans and the products or services offered, building financial models, and  
16 analyzing competitive trends.

17 3) After synthesizing and analyzing this information, analysts produced research in the form  
18 of full reports and more abbreviated formats that typically contained a rating, a price target,  
19 and a summary and analysis of the factors that generated the rating and/or price target. The  
20 Firm then distributed its analysts' research reports to the Firm's institutional clients, to the  
21 Firm's sales force and to retail clients upon request. Research reports were also made  
22 available to third party vendors, such as Bloomberg and First Call, who then made the  
23 reports available to subscribers to those vendors. In addition, the rating, but not the analysis  
24 contained in the research report, was published on Internet websites such as Multex, for  
25 viewing by the investing public. Similarly, UBS Warburg posted on its website (and  
26 provided in hard copy if requested), monthly summaries concerning the companies covered

1 by its research analysts, the ratings issued, and any ratings changes from the previous  
2 month. These summaries did not include any of the analyses contained in the actual  
3 research reports.

- 4 4) Analysts were required according to UBS Warburg policy to submit any proposed rating  
5 upgrades or downgrades and initiations of coverage to an Investment Review Committee  
6 (“IRC”) that consisted of compliance, institutional sales, equity capital markets and  
7 research department personnel. The IRC reviewed analysts’ reports and approved rating  
8 and target changes as well as initiations of coverage.
- 9 5) Nevertheless, analysts were sometimes able to upgrade or downgrade ratings by requesting  
10 and receiving approval of one of several designated members of Research Management,  
11 who were also members of the IRC, rather than the full IRC, whenever that change in rating  
12 was based upon breaking news. Because Firm analysts sometimes changed their ratings  
13 based upon breaking news, upgrades or downgrades were authorized without the approval  
14 of the full IRC in nearly one-third of the instances in which ratings were changed during the  
15 Relevant Period.
- 16 6) Analysts also made themselves available to the Firm’s institutional and retail sales force to  
17 answer questions about the sector and the covered companies. In addition, analysts  
18 provided periodic research updates to the Firm’s sales force through “morning calls” or  
19 “morning notes,” which are daily pre-market opening discussions of the market sectors and  
20 specific covered companies. Analysts also provided research updates through “blast” e-  
21 mails and voice messages, which typically provide a rating and a more abbreviated analysis  
22 than what is contained in a research report.
- 23 7) During the Relevant Period, analysts were expected to make independent determinations  
24 regarding coverage, stock price targets and ratings whether to buy, sell or hold certain  
25 stocks, without consideration of their research reports’ potential impact upon Firm  
26 investment banking business or the business of Firm investment banking clients.

- 1 8) In the 1990's the importance of research issued by analysts increased as a result of the  
2 dramatic growth in the number of individual investors and the availability of online trading.  
3 Research coverage became a marketing tool, and issuers sometimes chose an investment  
4 bank based upon the expectation that a certain analyst would cover the company's stock  
5 favorably.
- 6 9) As the performance and coverage of research analysts became increasingly integral to the  
7 awarding of investment banking business, the Firm encouraged its research analysts to  
8 become more involved in investment banking activities, including marketing securities  
9 issued by investment banking clients (primarily to the Firm's institutional clients) and  
10 soliciting investment banking business.

11 **D. Research Analyst Participation in Investment Banking Activities**

- 12 1) The Investment Banking Division at the Firm advised corporate clients and helped them  
13 execute various financial transactions, including the issuance of stock and other securities.  
14 The Firm frequently served as one of the underwriters in initial public offerings ("IPOs") –  
15 the first public issuance of stock of a company that has not previously been traded – and  
16 follow-on offerings of securities.
- 17 2) During the relevant period, investment banking was an important source of revenues and  
18 profits for UBS Warburg. UBS Warburg's investment banking department reported global  
19 revenues of \$1.369 billion in 1999, \$1.602 billion in 2000 and \$1.369 billion in 2001,  
20 representing nearly 15% of UBS Warburg's global revenues during that time period.
- 21 3) In addition to performing research functions, some of the Firm's research analysts  
22 identified companies as prospects for investment banking services, participated in "pitches"  
23 of the Firm's investment banking services to companies, and participated in "roadshows"  
24 and other activities in connection with the marketing of underwriting transactions. At  
25 times, Firm research analysts were involved in meetings between companies, prior to their  
26 IPO's, and some of the Firm's institutional customers who had expressed an interest in

1 purchasing shares in those IPOs. These meetings would take place in various cities all over  
2 the country in order to accommodate the institutional customers and were commonly  
3 known in the industry as “analyst roadshows.”

- 4 4) During these roadshows, the analyst would discuss the issuer with the institutional  
5 customers and would frequently arrange “one on one” meetings between company  
6 executives and managers of institutional clients who had expressed interest in investing.  
7 These roadshows were considered to be a service provided by the Firm to both its  
8 institutional clients as well as its investment banking clients.
- 9 5) Research analysts also participated in commitment committee and due diligence activities  
10 in connection with underwriting activities and assisted the Investment Banking Department  
11 in providing merger and acquisition and other advisory services to companies.
- 12 6) The interactions between investment bankers and certain research analysts during the  
13 Relevant Period, at times impacted the independence of those analysts’ as they became  
14 increasingly involved in the Firm’s efforts to secure investment banking business. As a  
15 result, an environment was created that may have led certain analysts to believe that they  
16 were expected to initiate and maintain positive research about Firm clients.

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18 **E. Participation in Investment Banking Activities was a Factor in Evaluating and**  
19 **Compensating Research Analysts**

- 20 1) The compensation system at the Firm provided an incentive for research analysts to  
21 participate in investment activities and to assist in generating investment banking business  
22 for the Firm.
- 23 2) The performance of research analysts was evaluated by Research Management through an  
24 annual review process and analysts’ bonuses were determined through this process, unless  
25 an analyst had a guaranteed bonus set by contract in advance. The guaranteed bonuses for  
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1 the Firm's top analysts were frequently in the millions of dollars while the base salary was  
2 typically in the \$125,000 to \$150,000 range.

3 3) In addition to these guaranteed bonuses, six PaineWebber analysts were explicitly  
4 guaranteed "investment banking bonuses", meaning that those analysts were entitled to  
5 some portion of certain investment banking fees earned by PaineWebber.

6 4) For example, two PaineWebber analysts were promised compensation equal to 15% of the  
7 underwriting management fees earned in their respective sectors. In addition to the bonuses  
8 paid to those analysts pursuant to PaineWebber's annual review process, those two analysts  
9 received an additional \$125,000 and \$135,000, respectively, for the year 2000, because of  
10 the investment banking fees earned by PaineWebber in their respective sectors.

11 5) When UBS Warburg acquired the research and investment banking operations of  
12 PaineWebber in November, 2000, the Firm removed the direct link between investment  
13 banking revenues and analyst compensation.

14 6) The UBS annual evaluation process included an evaluation of each analyst's contribution to  
15 the Firm's investment banking business as a factor in determining bonus compensation.

16 7) Each year, prior to bonuses being paid, UBS conducted a comprehensive evaluation process  
17 that rated each analyst's performance and assigned analysts rankings in one of four  
18 quartiles. As part of that process, analysts submitted self-evaluations, and other UBS  
19 employees with whom the analyst had had significant contact were also asked to submit  
20 evaluations, including investment bankers.

21 8) In describing the analysts' performance, the UBS bankers frequently included comments  
22 relating to the analyst's abilities to attract and/or maintain investment banking clients.

23 9) For example, an investment banker at UBS Warburg evaluated one analyst as "the best  
24 business builder in research I have ever known."

25 10) Similarly, Research Management considered investment banking contributions as a  
26 component of analysts' performance evaluations. The Head of UBS Warburg's Research



- 1 Division evaluated that same analyst as the “most prolific analyst at the firm when it comes  
 2 to generating investment banking revenues” and that he “manages the tightest coordination  
 3 between research and [the Corporate Finance Division] of any sector.” This evaluation was  
 4 included in the section of the performance review entitled “Accomplishment/Strengths.”
- 5 11) Furthermore, the Head of UBS Warburg’s Research Division, who was ultimately  
 6 responsible for evaluating analysts and determining the exact amount of their bonus  
 7 compensation, referenced analysts’ contributions to investment banking business as one  
 8 factor in the evaluation of their performance.
- 9 12) The Firm also specifically requested that analysts, in writing their own self-evaluations,  
 10 include, among other criteria, an assessment of their contribution to the Firm’s Investment  
 11 Banking Department. This led to a perception among analysts that contribution to  
 12 investment banking was a factor in compensation.
- 13 13) In response to this request, one analyst described his own performance for the Firm by  
 14 highlighting his involvement with several investment banking deals done by the Firm  
 15 during the previous year. The analyst then boasted that he was responsible for generating  
 16 \$15 million in investment banking revenue for the Firm during that time.

17 **F. Investment Banking Interests Influenced the Firm’s Decisions to Initiate and**  
 18 **Maintain Research Coverage**

- 19 1) In general, the Firm determined whether to initiate and maintain research coverage based  
 20 upon investor interest in a company or based upon investment banking considerations, such  
 21 as attracting companies to generate investment banking business or maintaining a positive  
 22 relationship with existing investment banking clients.
- 23 2) As a matter of practice, the Firm initiated coverage on companies that engaged the Firm in  
 24 an investment banking transaction and maintained coverage for a period of time beyond the  
 25 transaction.  
 26

- 1 3) Research analysts were aware that, in certain circumstances, their positive and continued  
2 coverage of particular companies was an important factor for the generation of investment  
3 banking business. Thus, some research analysts and investment bankers coordinated the  
4 initiation and maintenance of research coverage based upon, among other things,  
5 investment banking considerations.
- 6 4) For example, analysts were required to seek authorization from Research Management prior  
7 to dropping coverage of a company, unless the reason for dropping coverage was due the  
8 departure of the covering analyst. However, when the company involved was an  
9 investment banking client, the analyst was also expected to consult with the investment  
10 banking personnel responsible to that client.
- 11 5) Additionally, according to an e-mail by UBS Warburg Head of Global Technology  
12 Investment Banking, it was an implicit condition in the UBS Warburg investment banking  
13 agreements that UBS Warburg would continue to provide research coverage of its clients  
14 for a period of time following a transaction. Such implied promises to investment banking  
15 clients impacted the Research Department's authority to make its own independent  
16 determinations concerning the continuation of coverage.
- 17 6) When a UBS Warburg analyst informed the Head of the Research Department that he  
18 intended to drop coverage of a particular company, he was asked whether there was any  
19 "banking relationship" and was told to "check with" the banker who worked with that  
20 company.
- 21 7) Although coverage of the company was dropped in that instance, the lead banker of the  
22 technology group at UBS Warburg reminded the research analyst and Research  
23 Management of the implicit promise made during pitch meetings that coverage would be  
24 maintained for a significant period of time: "The problem is that many companies . . . in  
25 asking for credentials for a pitch will ask directly if we are meeting our research obligations  
26

1 to the companies we bank. They generally expect an IPO fee to justify coverage for three  
2 years . . .”

3 8) In another instance, when a UBS Warburg research analyst informed his banking  
4 counterpart, that he intended to drop coverage of four biotechnology companies, the banker  
5 forwarded that message to a member of Investment Banking Management who sent an e-  
6 mail to the analyst stating that he wished “to have the opportunity to discuss future potential  
7 revenue opportunities from these clients” before coverage was dropped.

8 9) The Investment Banking Department also sometimes had an impact upon determinations  
9 made by analysts regarding the initiation of coverage. When investment bankers became  
10 aware of opportunities to cultivate investment banking business, they sometimes suggested  
11 to the analyst in that sector that coverage should be initiated.

12 10) For example, a Firm investment banker sent an e-mail to a Firm research analyst indicating  
13 that a company with whom he had discussed investment banking business had asked “if  
14 there was an interest by UBS Warburg to cover them from a research stand point.” The  
15 banker went on to say that he believed that “the timing is good” for initiation of research  
16 coverage of the company and offered to set up a meeting between the company and the  
17 analyst.

18 11) Similarly, a Firm analyst informed his banking counterparts that they should wait to call a  
19 company to discuss a potential investment banking deal until “after I pick up coverage.”

20 **G. The Firm’s Pitch Materials Contained Discussions of Research Coverage**

21 1) During the relevant period, research coverage was an important factor considered by  
22 companies in selecting a firm for an investment banking transaction.

23 2) Certain analysts understood that the issuance of positive research about an issuer was a pre-  
24 condition to the Firm’s obtaining the issuer’s banking business.

25 3) In competing for investment banking business from prospective issuers, the Firm typically  
26 sent investment bankers to meet with company management in order to persuade the

1 company to select the Firm as one of the underwriters in a contemplated transaction.

2 Research analysts often accompanied bankers on these “pitch” meetings. At these  
3 meetings, Firm investment bankers would present their level of expertise in the company’s  
4 sector and discuss their previous experience with other companies, as well as their view of  
5 the company’s merits and likelihood of success.

6 4) In some instances, the research analyst’s coverage and impact on the market place  
7 concerning companies under coverage was a component of the pitch presented by the Firm.  
8 As a result of these presentations, certain issuers selected an investment bank because of the  
9 reputation of the analyst that would cover the company’s stock and the issuer’s belief that  
10 the coverage would be positive.

11 5) Furthermore, certain research analysts who covered the company’s sector often worked  
12 with investment bankers to prepare the Firm’s pitch presentation and attended the pitch  
13 meeting.

14 6) In preparation for each presentation, the investment bankers, sometimes with an analyst’s  
15 input, prepared a “pitch book” that was distributed at the meeting and contained a summary  
16 of the Firm’s presentation.

17 7) Some pitch books contained information relating to the company, its competition, the sector  
18 in which it operated and the nature of the services the Firm could provide to the company  
19 and its shareholders after the completion of a potential offering. Additionally, Firm pitch  
20 books sometimes contained implicit representations that the Firm would continue to  
21 provide service to the issuer after the offering by providing research coverage about the  
22 company.

23 8) Some pitch books contained information indicating that a specific analyst would cover the  
24 company and included data demonstrating how that analyst’s positive comments about  
25 other companies in the sector had had a direct positive impact upon the stock prices of those  
26 companies.

- 9) For example, the pitch book presented to JDS Uniphase by PaineWebber, discussed the impact that PaineWebber research had on covered stocks by including a graphic depicting the performance of stocks on the Firm's "Buy List" as opposed to stocks on the Firm's "Attractive List" and "Neutral List." At the top of the graphic, PaineWebber quoted a report from Reuters which stated, "Shares of semiconductor companies specializing in chips for the communications market rose on Thursday after PaineWebber published a report citing the sector's growth prospects."
- 10) Similarly, in a pitch book presented to Avant Immunotherapeutics, Inc., PaineWebber presented a slide entitled "Demonstrated Strength in Equity Trading and Research." One of the sub-topics on the slide stated, "Buy and attractive recommendations have outperformed the S&P 500 by 84 percentage points for the period 1/90 through 12/99" while "Sell and unattractive ratings have underperformed the S&P 500 by 361 percentage points for the period 1/90 through 12/99."
- 11) Because analysts often participated in the Firm's efforts to win investment banking business, analysts were sometimes subjected to competing pressures after a stock became publicly traded. The type of information contained in the pitch books, such as the examples above, implied to issuers that the Firm would provide positive research coverage if selected for an investment banking transaction, and that such coverage could result in rising stock prices for those companies.

#### **H. Research Analysts Rarely Issued Neutral or Negative Ratings**

- 1) During the relevant period, PaineWebber's rating system allowed research analysts to assign one of four ratings to a stock: "Buy", defined as total return expected to exceed that of the S&P 500 by 20 percentage points or more over the next 12 months; "Attractive", 12 month total return potential that is 10-20 percentage points greater than the market's; "Neutral", 12 month total return potential within 10 percentage points of the market's;

1 “Unattractive”, expected to underperform the market by more than 10 percentage points on  
2 a total return basis over the next 12 months.

3 2) During the relevant period, UBS Warburg’s rating system differed slightly from  
4 PaineWebber’s and allowed research analysts to assign one of five ratings to a stock:  
5 “Strong Buy”, defined as greater than 20% excess return potential; “Buy”, positive excess  
6 return potential; “Hold”, low excess return potential; “Reduce”, negative excess return  
7 potential; “Sell”, greater than 20% negative excess return potential. All of these ratings  
8 related to a 12 month time horizon.

9 3) During the relevant period, the level of the price target and the strength of the  
10 recommendation placed on a stock by covering analysts sometimes had a significant impact  
11 on the stock price. Investment bankers and issuers, being fully aware of the potential  
12 impact of analysts’ recommendations, were motivated to seek research coverage containing  
13 positive recommendations.

14 4) In fact, certain analysts considered the investment banking implications for the Firm when  
15 contemplating issuing even a neutral rating about an investment banking client. For  
16 example, a member of Equity Sales Management, sent an e-mail to one of UBS Warburg’s  
17 telecom analysts stating “The salesforce is extremely frustrated with your research, price  
18 targets, ratings . . . . They feel that you’re being somewhat flippant and not taking  
19 responsibility for your recommendations and for having lost hundreds of millions of dollars  
20 for people.” The analyst responded that he would never utilize a Hold rating on a stock  
21 unless one of two conditions occurred: “1) if I believe the company is about to go  
22 bankrupt; 2) if there is no investment banking business to be had there.”

23 5) Notwithstanding that PaineWebber had four available ratings and UBS Warburg had five,  
24 the Firm’s research analysts rarely issued ratings other than “Strong Buy” and “Buy” on the  
25 stocks of investment banking clients. Out of several thousand companies covered by UBS  
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- 1 Warburg during the relevant period, UBS Warburg issued only seven “Hold” ratings and  
2 two “Sell” ratings on companies with which it had an investment banking relationship.
- 3 6) Similarly, from July 1, 1999 until the time of the merger, PaineWebber issued only sixteen  
4 “Neutral” ratings and five “Unattractive” ratings on companies with which it had an  
5 investment banking relationship.

6 **I. In Certain Instances, the Firm Published Exaggerated or Unwarranted Research**

- 7 1) On several occasions, the conflicts of interest discussed above resulted in analysts  
8 publishing ratings and/or recommendations that were exaggerated or unwarranted, and/or  
9 contained opinions for which there was no reasonable basis. The following are examples of  
10 how these conflicts affected the research:
- 11 2) In April of 1998, UBS Warburg served as the lead manager on an IPO for Triangle  
12 Pharmaceuticals (“Triangle”) and received \$1.8 million in investment banking fees.
- 13 3) Notwithstanding a market capitalization value of approximately \$352,000,000, in  
14 November of 1999, Triangle had yet to earn any revenue. Rather, investor optimism for the  
15 stock was based upon the anticipated approval by the Food and Drug Administration  
16 (“FDA”) of several new drugs, including its “lead HIV drug”, Coactinon.
- 17 4) In a research report issued on October 8, 1999, the UBS Warburg research analyst who  
18 covered Triangle issued a research report that maintained a “Buy” rating while relaying  
19 news to investors that a study of the drug Coactinon had proved “inconclusive.” The  
20 analyst also wrote that the form of testing used by Triangle to gain approval from the FDA  
21 had been used before but “had been in less favor recently,” and that accordingly it “is  
22 unclear what the FDA’s requirements will now be” for testing the drug.
- 23 5) On December 10, 1999, the FDA informed the company that it would require an additional  
24 round of testing, which would cause at least a substantial delay, and perhaps ultimately a  
25 cancellation, of the release and sale of the drug. As a result the stock price fell more than  
26 \$3 -- or 23% -- from \$15.63 to \$12.00 on the date of the announcement.

- 1 6) On that same day, the analyst published a new research report in which she relayed the  
2 news to investors but maintained her “Buy” rating, based in part, according to the report,  
3 upon the analyst’s belief that a different drug in development by Triangle was the  
4 company’s “most important near-term opportunity.”
- 5 7) The analyst spoke to the UBS Warburg sales force before the market opened following  
6 Triangle’s announcement of the FDA’s decision and made a statement in form or in  
7 substance that the FDA’s action had been an anticipated possibility notwithstanding the  
8 analyst’s “Buy” rating on the stock.
- 9 8) Following that call, a member of UBS Warburg’s Equity Trading Management contacted  
10 the analyst by e-mail and expressed disappointment that the analyst anticipated that the  
11 FDA might take this action but had failed to adequately emphasize that possibility to the  
12 sales force.
- 13 9) The analyst responded that her failure to emphasize negative information regarding  
14 Triangle was, at least partially, a result of the analyst’s allegiance to the investment banking  
15 client: “Triangle is a very important client of [the firm]. We could not go out with a big  
16 research call trashing their lead product, although we had a feeling the FDA might balk.  
17 Had we been right or wrong, it would have been a disaster. I just wanted the salesforce to  
18 know we were not surprised, and that where appropriate we had had some conversations  
19 with the buy-side. Sorry this was not conveyed.”
- 20 10) Similarly, in September 1999, UBS Warburg acted as a co-lead underwriter of Interspeed’s  
21 IPO and received approximately \$700,000 in investment banking fees as a result.
- 22 11) In October 1999, the analyst initiated coverage on Interspeed with a “Buy” rating and a \$15  
23 price target and maintained that position for several months. On January 3, 2000, the  
24 Firm’s analyst received an e-mail from a junior analyst who asked what to do if  
25 Interspeed’s annual report reflects inventory and a sales breakout which “differ materially  
26



1 from what we have in the model.” The junior analyst also remarked that Interspeed should  
2 “get new auditors, their cash flow statement doesn’t add up.”

3 12) That same day, the analyst issued a research report stating the Interspeed had fallen  
4 “dramatically short on the top line” in the prior quarter “due to various consumer financing  
5 and delivery issues.” Additionally, the analyst issued the “Buy” rating in spite of the fact  
6 that the stock price had risen above the analyst’s price target.

7 13) Two days later, on January 5, 2000, the analyst instructed a member of the Firm’s sales  
8 force, “Don’t put people into Interspeed – very risky.” Nevertheless, the analyst maintained  
9 his Buy rating on the stock.

10 14) Approximately 15 minutes later, the recipient of that e-mail replied, asking “so why is ispd  
11 [stock symbol for Interspeed] a short?” The analyst replied, “Just lumpy revenue, some  
12 stuffing of channel, creative accounting.”

13 15) The analyst’s reference to “customer financing and delivery issues” in his January 3<sup>rd</sup> report  
14 should have more fully described his concern that Interspeed was suffering from lumpy  
15 revenue or channel stuffing.

16 16) A week after that, on January 11, 2000, the analyst received a question from an institutional  
17 sales force member asking about Interspeed. He responded, “BE CAREFUL about being  
18 long Interspeed. They will report a great number for the December quarter, at least on the  
19 surface of things, but the quality of that number is not necessarily self-evident.” (emphasis  
20 in the original).

21 17) On February 4, 2000, the UBS Warburg analyst issued another research report following  
22 Interspeed’s announcement of its fourth quarter results, which exceeded the analyst’s  
23 expectations. In that report, the analyst reiterated his “Buy” rating and raising his price  
24 target from \$15 to \$28.

25 18) On March 20, 2000, while the analyst still maintained his “Buy” rating and \$28 price target  
26 and with the stock price exceeding that target, the analyst sent an e-mail to UBS Warburg’s

- 1 sales force informing them that another company had developed a product to compete with  
2 Interspeed. One of the members of the sales force responded, "This sounds like a short . . .  
3 correct? (Off the record, of course)." The analyst responded, "YES." However, the  
4 analyst still maintained the "Buy" rating.
- 5 19) On May 31, 2000, the analyst sent an e-mail to two institutional customers saying that "The  
6 two shorts of the group I would suggest are (1) [another issuer] and (2) Interspeed. I'd be  
7 wary of shorting any of the others." Nevertheless, the analyst still maintained his "Buy"  
8 rating on Interspeed.
- 9 20) On July 21, 2000, the analyst dropped the rating on Interspeed from a "Buy" to a "Hold".

10 **J. UBS Warburg Received and Made Payments for Research**

- 11 1) UBS Warburg received payments from the lead manager of offerings in which UBS  
12 Warburg did not participate for the issuance of research during the relevant time period.
- 13 2) During the relevant period, UBS Warburg received a payment of \$100,000 from an outside  
14 firm in connection with the offering of Flextronics International, Ltd. The cover letter  
15 enclosing the check indicated that the check was a "special research check." However,  
16 UBS Warburg failed to disclose in its research reports concerning Flextronics that it had  
17 received the payment, nor did it disclose the source or amount of the payment.
- 18 3) During the relevant period, UBS Warburg also received a payment from an outside firm in  
19 the amount of approximately \$113,000 in connection with the offering of Atmel, Inc. The  
20 cover letter enclosing the check stated that the check represented "guaranteed economics  
21 for research." However, UBS Warburg failed to disclose in its research reports concerning  
22 Atmel that it had received the payment, nor did it disclose the source or amount of the  
23 payment.
- 24 4) During the relevant period, UBS Warburg also paid a "research fee" of \$150,000 at the  
25 direction of the issuer, to two broker-dealers in conjunction with the underwriting  
26 transaction of Netopia, Inc. in which UBS Warburg was the lead-manager. However, UBS

Warburg did not take steps to ensure that this broker-dealer disclosed in its research reports that it had been paid to issue research. Further UBS Warburg did not disclose or cause to be disclosed the details of these payments.

- 5) During the relevant period, UBS Warburg also made several payments totaling approximately \$283,000, at the direction of the issuer, for “research” to broker-dealers in conjunction with an underwriting transaction of Espeed, Inc., in which UBS Warburg was the lead manager. However, UBS Warburg did not take steps to ensure that this broker-dealer disclosed in its research reports that it had been paid to issue research. Further UBS Warburg did not disclose or cause to be disclosed the details of these payments.

**K. The Firm Failed To Adequately Supervise Its Research and Investment Banking Departments**

- 1) While one of the roles of research analysts was to produce objective research, the Firm also encouraged them to participate in investment banking activities. As a result of the foregoing, these analysts were subject to investment banking influences and conflicts of interest between supporting the Firm’s investment banking business and publishing objective research.
- 2) The Firm had knowledge of these investment banking influences and conflicts of interest yet failed to manage them adequately to protect the objectivity of its published research.
- 3) The Firm failed to establish and maintain adequate policies, systems and procedures reasonably designed to ensure the objectivity of its published research. Although the Firm had some policies governing research analyst activities during the relevant period, these policies were not adequate to fully address the conflicts of interest that existed.

**II.**

**CONCLUSIONS OF LAW**

1. The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona Constitution and the Securities Act.

1       2. The Firm committed dishonest or unethical practices in the securities business under A.R.S.  
2 §44-1961(A)(13) within meaning of A.A.C. R14-4-130 by:

- 3           i. engaging in the acts and practices that created or maintained inappropriate influence  
4           by the Investment Banking Department over research analysts, therefore imposing  
5           conflicts of interest on its research analysts, and failing to manage these conflicts in  
6           an adequate or appropriate manner;
- 7           ii. issuing research reports that were affected by the conflicts of interest imposed on its  
8           research analysts as described above;
- 9           iii. making payments for research to other broker-dealers not involved in underwriting  
10          transactions when the Firm knew that these payments were made, at least in part, for  
11          research coverage, and by failing to disclose or cause to be disclosed in offering  
12          documents or elsewhere the fact of such payments;
- 13          iv. receiving payments in conjunction with underwriting transactions from outside  
14          entities for research issued without disclosing receipt of those payments to the  
15          public as required by Section 17(b) of the Securities Act of 1933, as amended; and
- 16          v. failing to establish and maintain adequate policies, systems and procedures for  
17          supervision and control of the Research and Investment Banking Departments  
18          reasonably designed to detect and prevent the foregoing investment banking  
19          influences and manage the conflicts of interest to assure compliance with applicable  
20          securities laws and regulations.

21       3. The Firm's conduct is grounds for administrative penalties under A.R.S. § 44-1961(B)(1).

22       4. The Firm's conduct is grounds for a cease and desist order pursuant to A.R.S. § 44-  
23       1961(B)(2).

24       5. The Firm's conduct is grounds for an order requiring the Firm to take affirmative action to  
25       correct the conditions and practices giving rise to this action pursuant to A.R.S. § 44-  
26       1961(B)(3).

**III.****ORDER**

On the basis of the Findings of Fact, Conclusions of Law, and UBS Warburg's and UBS PaineWebber's consent to the entry of this Order, for the sole purpose of settling this matter, prior to a hearing and without admitting or denying any of the Findings of Fact or Conclusions of Law, the Commission finds that the following relief is appropriate, in the public interest, and necessary for the protection of investors.

**THEREFORE, IT IS HEREBY ORDERED:**

1. This Order concludes the investigation by the Commission and any other action that the Commission could commence under applicable Arizona law on behalf of Arizona as it relates to the Firm, relating to certain research practices at the Firm described herein.

2. Pursuant to A.R.S. § 44-1961(B)(2) and (3), the Firm will CEASE AND DESIST from violating the Securities Act and will comply with the Securities Act in connection with the research practices referenced in this Order and will comply with the undertakings of Addendum A, incorporated herein by reference.

3. Pursuant to A.R.S. § 44-1961(B)(1), the Firm shall pay an administrative penalty in the amount of \$395,321.00.

4. If payment is not made by the Firm or if the Firm defaults in any of its obligations set forth in this Order, the Commission may vacate this Order, at its sole discretion, upon 10 days notice to UBS and without opportunity for administrative hearing.

5. The Firm agrees that it shall not seek or accept, directly or indirectly, reimbursement or indemnification, including but not limited to payment made pursuant to any insurance policy, with regard to all penalty amounts that the Firm shall pay pursuant to this Order or section II of the SEC Final Judgment, regardless of whether such penalty amounts or any part thereof are added to the Distribution Fund Account referred to in the SEC Final Judgment or otherwise used for the benefit of investors. The Firm further agrees that it shall not claim, assert, or apply for a tax deduction or

1 tax credit with regard to any state, federal or local tax for any penalty amounts that the Firm shall  
2 pay pursuant to this Order or section II of the SEC Final Judgment, regardless of whether such  
3 penalty amounts or any part thereof are added to the Distribution Fund Account referred to in the  
4 SEC Final Judgment or otherwise used for the benefit of investors. The Firm understands and  
5 acknowledges that these provisions are not intended to imply that the Commission would agree that  
6 any other amounts the Firm shall pay pursuant to the SEC Final Judgment may be reimbursed or  
7 indemnified (whether pursuant to an insurance policy or otherwise) under applicable law or may be  
8 the basis for any tax deduction or tax credit with regard to any state, federal or local tax.

9 6. This Order is not intended by the Commission to subject any Covered Person to any  
10 disqualifications under the laws of any state, the District of Columbia or Puerto Rico (collectively,  
11 "State"), including, without limitation, any disqualifications from relying upon the State  
12 registration exemptions or State safe harbor provisions. "Covered Person" means the Firm, or any  
13 of its officers, directors, affiliates, current or former employees, or other persons that would  
14 otherwise be disqualified as a result of the Orders (as defined below).

15 7. The SEC Final Judgment, the NYSE Stipulation and Consent, the NASD Letter of  
16 Acceptance, Waiver and Consent, this Order and the order of any other State in related proceedings  
17 against the Firm (collectively, the "Orders") shall not disqualify any Covered Person from any  
18 business that they otherwise are qualified, licensed or permitted to perform under the applicable  
19 law of Arizona and any disqualifications from relying upon this state's registration exemptions or  
20 safe harbor provisions that arise from the Orders are hereby waived.

21 8. The Orders shall not disqualify any Covered Person from any business that they otherwise  
22 are qualified, licensed or permitted to perform under applicable state law.

23 9. For any person or entity not a party to this Order, this Order does not limit or create any  
24 private rights or remedies against the Firm including, without limitation, the use of any e-mails or  
25 other documents of the Firm or of others regarding research practices, or limit or create liability of the  
26 Firm, or limit or create defenses of the Firm to any claims.

10. Nothing herein shall preclude Arizona, its departments, agencies, boards, commissions, authorities, political subdivisions and corporations, other than the Commission and only to the extent set forth in paragraph 1 above, (collectively, "State Entities") and the officers, agents or employees of State Entities from asserting any claims, causes of action, or applications for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive relief against the Firm in connection with certain research practices at the Firm.

IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

/s/ Marc Spitzer

CHAIRMAN

William A. Mundell

COMMISSIONER

Jeffrey Hatch-Miller

COMMISSIONER

Lowell Gleason

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 16th day of May, 2003.

/s/ Michael Kerns for BCM

BRIAN C. McNEIL

Executive Secretary

/s/ James Irvin

DISSENT

DISSENT

This document is available in alternative formats by contacting Shelly M. Hood, Executive Assistant to the Executive Secretary, voice phone number 602-542-3931, E-mail [shood@cc.state.az.us](mailto:shood@cc.state.az.us).

(PAH)

**CONSENT TO ENTRY OF ADMINISTRATIVE ORDER**  
**BY UBS WARBURG**

UBS WARBURG hereby acknowledges that it has been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

UBS WARBURG admits the jurisdiction of the Commission, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order by the Commission as settlement of the issues contained in this Order.

UBS WARBURG states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

Jenkins & Dinerstein represents that he/she is they are managing directors of UBS WARBURG and that, as such, has been authorized by UBS WARBURG to enter into this Order for and on behalf of UBS WARBURG.

Dated this 24th day of April, 2003.

UBS Warburg LLC

UBS Warburg LLC

By: /s/ Jenkins

By: /s/ Dinerstein

Title: Managing Director

Title: Managing Director and Global General Counsel

SUBSCRIBED AND SWORN TO before me this 24th day of April, 2003.

/s/ Laurie Y. Ingram

Notary Public

My Commission expires:  
July 31, 2006



**CONSENT TO ENTRY OF ADMINISTRATIVE ORDER**  
**BY UBS PAINWEBBER INC.**

UBS PAINWEBBER hereby acknowledges that it has been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

UBS PAINWEBBER admits the jurisdiction of the Commission, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order by the Commission as settlement of the issues contained in this Order.

UBS PAINWEBBER states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

Grano & Levine represents that he/she is they are Chairman & Chief Executive Officer and Chief Legal Officer & Executive Vice President of UBS PAINWEBBER and that, as such, has been authorized by UBS PAINWEBBER to enter into this Order for and on behalf of UBS PAINWEBBER.

Dated this 24th day of April, 2003.

UBS PaineWebber Inc.

UBS PaineWebber Inc.

By: /s/ Theodore A. Levine

By: /s/ Joseph J. Grano, Jr.

Title: Chief Legal Officer  
and Executive Vice President

Title: Chairman and Chief Executive Officer

SUBSCRIBED AND SWORN TO before me this 24th day of April, 2003.

/s/ Catherine A. Gaffney

Notary Public

My Commission expires:

May 31, 2007